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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 990

JOSEPHINE V. HALL,

Petitioner,

v.

THE UNITED STATES.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

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Petition.

The above named taxpayer by her counsel, prays that a writ of certiorari issue to review the judgment of the Court of Claims entered in the above case February 2, 1942 (R. 17).

Jurisdiction.

The judgment of the Court of Claims was entered February 2, 1942 (R. 17). The jurisdiction of this Court is found in section 240 of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Two questions were presented to the Court of Claims. Certiorari is sought only on the second question which is:

Is the principle of recoupment, as applied in *Bull* v. *United States,* 295 U. S. 247, applicable under the circumstances of the case at bar?

Or, expressed in another manner, should the Commissioner of Internal Revenue in assessing and collecting income taxes from the petitioner for the years 1933 to 1935, inclusive, have reduced those taxes by way of recoupment and by an offset and credit in the amount of petitioners overpayment of income tax for prior years and, whether or not he should have done so, should the Court of Claims have done so?

Statement.

The facts which are fully and fairly found by the Court of Claims (R. 5-10), are summarized as follows:

The petitioner, Josephine V. Hall, was one of the life beneficiaries of a testamentary trust created by her father, who died February 10, 1910. The corpus of the trust consisted primarily of two leaseholds at 634 and 636 Fifth Avenue, New York City. The terms of both leases expired May 1, 1938.

Under the trust, as construed by the courts of New York, the life beneficiaries, including the petitioner, were entitled to the entire net income of the trust and the trustees were not required or permitted to set up a fund out of income for depreciation or amortization.

Prior to 1929, the Commissioner of Internal Revenue did not allow the beneficiaries (including petitioner) to deduct from income received any allowance for exhaustion, wear, tear, obsolescence, amortization or depreciation, nor

did he allow the trustees any like deduction because they had not actually withheld any income and had not set up any reserve.

June 8, 1932, the trustees sold the leaseholds for $1,017,750.00, payable in equal monthly installments over a period of sixty-nine months, ending April 16, 1938.

Under the power and authority vested in the trustees under the will of Thomas A. R. Hall, the proceeds from the sale of the leaseholds were paid direct to the beneficiaries, each receiving one-third.

In computing the gain on the said sale, the Commissioner of Internal Revenue reduced the basis for computing gain or loss by depreciation on the building and amortization of the leases from March 1, 1913, to the date of the sale, although he had refused to allow such a deduction from either the income of the trustees, or the beneficiaries, prior to 1929.

As a result of the said action of the Commissioner of Internal Revenue, the petitioner was compelled to pay additional income tax and interest thereon for the years 1932, 1933, 1934 and 1935 in the respective amounts of $1,918.19, $10,032.40, $68.60 and $903.37.

Petitioner filed timely claims for the refund of the amounts stated in the preceding paragraph on the grounds:

(1) As a deduction for depreciation and amortization had not been allowed to the trustees, nor to the petitioner, prior to 1929, the basis for computing gain on the sale should not be reduced by such allowances.

(2) Petitioner was entitled to recoupment for 1932, 1933, 1934 and 1935 because depreciation and amortization allowances for the years prior to 1929 had been used to reduce the basis in computing gain on the sale, although no de-

ductions therefore had been allowed in computing income for the years prior to 1929.

The Court of Claims held against the petitioner on both issues (R. 11-17). Certiorari is sought limited to the second, or recoupment issue.

Statutes Involved.

The applicable portions of the relevant statutes are set forth in the appendix, *infra*, p. 10.

Specification of Errors.

The Court of Claims erred:

1. In holding that the principle of recoupment as applied in *Bull* v. *United States*, 295 U. S. 247 does not apply in this case.

2. In holding that the income taxes overpaid by the petitioner, as a result of the action of the Commissioner of Internal Revenue, for years prior to 1929 should not be offset or credited against petitioner's income taxes for the years 1932 to 1935, inclusive.

3. In holding that the petitioner is not entitled to recover.

Reasons for Granting the Writ.

This petition is sought to resolve the conflict between the Court of Claims and Circuit Courts of Appeal, as will hereinafter be particularly pointed out, on the important and at present confused, question of whether *Bull* v. *United States*, 295 U. S. 247, has been overruled or nullified by *McEachern* v. *Rose*, 302 U. S. 56. Or, stated otherwise, whether equitable principles are to be considered in determining Federal tax liabilities.

In the *Bull* case partnership earnings accruing after Bull's death were subjected to estate tax. Later the Com-

missioner of Internal Revenue determined the said earnings represented income to the estate and collected a deficiency in income tax after the refund of the estate tax was outlawed. Suit was filed in the Court of Claims but was dismissed, 79 Ct. Cls. 133, 6 F. Supp. 141, as was the case at bar, on the ground that the action was barred by limitations. This Court reversed on the theory of recoupment because retention of the money would be "immoral and amounts in law to a fraud on the taxpayers rights."

In the *McEachern* case, the taxpayer made an installment sale of stock in 1924, and elected to return the profit on the installment basis over a ten year period. After his death in 1928 his administrator filed returns for 1928 to 1931, inclusive, which erroneously showed a sale of a part of the stock in each of the said years, whereas he should have reported, as income for 1928, the capital gain included in the value of the unpaid installments at the time of the taxpayer's death. After limitations expired for assessing additional taxes for 1928, the administrator sued for refunds for 1929 to 1931, inclusive. This Court allowed recovery and did not permit the outlawed 1928 tax to be offset against the 1929 to 1931 refunds. A distinguishing feature of the *McEachern* case is that the taxpayer had elected to return the transaction on the installment basis. The Commissioner was thus put on notice of the true facts, so no element of estoppel existed.

In the case at bar the Court of Claims thought the *McEachern* case rather than the *Bull* case controls.

I.

The decision of the Court of Claims is in conflict with decisions of this Court. The recoupment principle, as applied in Federal tax cases, is similar to the old doctrine of unjust enrichment, an equitable doctrine of general application available as a defense to an action where to allow re-

covery would result in unjustified enrichment of the plaintiff. *Meyers* v. *Hurley Motor Co.*, 273 U. S. 18.

The application of recoupment in Federal tax cases was first announced by this Court in *Bull* v. *United States*, 495 U. S. 247 and *Stone* v. *White*, 301 U. S. 532, indicates that its application in such cases is fully accepted.

It is stated in *Stone* v. *White* (p. 534).

> "The action, brought to recover a tax erroneously paid, although an action at law, is equitable in its function. It is the lineal successor of the common Count in indebitatus assumpsit for money had and received * * *."
>
> "Its use to recover upon rights equitable in nature to avoid unjust enrichment by the defendant at the expense of the plaintiff, and its control in every case by equitable principles * * * have long been recognized in this Court * * *. It is an appropriate remedy for the recovery of taxes erroneously collected, * * *"

At page 539 the court, in speaking of recoupment, states:

> "Such a defense is never barred by the statute of limitations so long as the main action itself is timely". *Bull* v. *United States* 295 U. S. 247; *Williams* v. *Neely* (C. C. A. 8th), 134 F. 1, 13. Compare *United States* v. *Macdaniel*, 7 Pet. 1, 16; *United States* v. *Ringgold*, 8 Pet. 150, 163, 164, where equitable recoupment against a claim by the government was allowed notwithstanding the immunity of the government from suit".

II.

The decision of the Court of Claims is in direct conflict with the *Dixie Margarine Co.* v. *Commissioner*, 115 F. (2d) 445, wherein the Sixth Circuit, on the authority of the *Bull* case, permitted recovery under the following facts: The Commissioner of Internal Revenue claimed a deficiency in income tax for 1932 as a result of refunds

of oleomargarine taxes illegally collected for 1925 to 1931. Similar oleomargarine taxes had also been collected for 1923 to 1925 but the recovery thereof was barred by limitation. The amount of the barred refunds exceeded the proposed deficiency. The Court held that the barred refunds of oleomargarine tax could be recouped and used as an offset against the 1932 deficiency in income tax because both taxes had a common origin.

Obviously the taxes involved in the *Dixie Margarine* case did not involve the identical sum of money or grow out of the same transaction, which was reason given by the Court of Claims for not applying the rule of the *Bull* case in the case at bar. In fact, in the *Dixie Margarine* case, an oleomargarine tax was allowed as a recoupment against an income tax, an altogether different type of tax. In the case at bar only income taxes are involved and for all years grow out of the identical adjustments to income on the identical properties. The conflict is direct and irreconcilable.

III.

The decision of the Court of Claims is in conflict with the Seventh Circuit in *Lofquist Realty Co.* v. *Commissioner,* 102 F. (2d) 945, which discusses the *McEachern* case, yet the Court had no difficulty in applying the equitable rule of *Stone* v. *White.* In the *Lofquist* case the corporation made an installment sale of a leasehold in 1929. In the same year it assigned the sales contract to its sole stockholder, but did not mention the assignment on its tax return. In its 1930, 1931 and 1932 tax returns it represented the installment payments as its own income. After it was too late to collect the proper tax from the sole stockholder for 1929 the Corporation sought a refund of the 1932 tax on the ground that the sole stockholder owned the sales contract. The Seventh Circuit held that

the Corporation was estopped to set up the true facts in its action to recover 1932 taxes. That, in effect, permitted recoupment of the barred claim by the government to the extent of the refund sought.

IV.

Whether or not broad equitable principles are to apply both for and against the government in tax cases is a matter of great public importance. If the rule of the case at bar is law and equitable considerations have no bearing in the decision of tax cases, it means that, in situations such as in the Lofquist case, future decisions must be directly opposite to that in the *Lofquist* case, with the resulting adverse effect upon the revenue. See *Grand Central Public Market* v. *United States*, 22 F. Supp. 119 (S. D. Calif.), where the government unsuccessfully attempted to offset barred additional income taxes for 1925, 1926, 1927 and 1928 against an admitted overpayment of similar tax for 1929, under circumstances similar to those in the *McEachern* case. On the other hand in *West Virginia Pulp & Paper Co.* v. *McElligott* (S. D. N. Y.), 40 F. Supp. 765, recoupment was permitted in favor of the government and the *McEachern* case held not to apply.

In addition the proper application of the *Bull, Stone* v. *White* and *McEachern* cases has resulted in much litigation.

According to the Prentice-Hall Federal Tax Citator Service the *Bull* case has been cited approximately 91 times; *Stone* v. *White* 62 times, and *McEachern* v. *Rose* 32 times up to February 21, 1942. It would seem that if this vexing question is settled by this Court, much litigation may be avoided. Illustrative are the *Grand Central Public Market* and *West Virginia Pulp & Paper Co.* cases previously cited, *Henry E. Mills* v. *United States* (N. D. N. Y.) 35

F. Supp. 738, and the Court of Claims case of *Dunigan* v. *United States*, 87 Ct. Cls. 404, 23 F. Supp. 467.

Conclusion.

For the reasons stated the petition should be granted.

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